No. 73-718

IN THE

Supreme Court of the United States

October Term, 1973

BANGOR PUNTA OPERATIONS, INC. and
BANGOR PUNTA CORPORATION,
Petitioners

v.

BANGOR & AROOSTOOK RAILROAD COMPANY and
BANGOR INVESTMENT COMPANY,
Respondents

ON PETITION FOR A WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BRIEF FOR THE RESPONDENTS IN OPPOSITION

EDWARD O. PROCTOR
ALAN L. LEFKOWITZ
EDWARD T. ROBINSON
ELY, BARTLETT, BROWN & PROCTOR
225 Franklin Street
Boston, Massachusetts 02110
Counsel for Respondents

VERRILL, DANA, PHILBRICK,
PUTNAM & WILLIAMSON,
Of Counsel.

November 29, 1973

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CITATIONS

CASES:

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Opinions Below

The opinion of the District Court is reported at 353 F.Supp. 724 (D. Me. 1972). The opinion of the Court of Appeals is reported at 482 F.2d 865 (CA1 1973).

Jurisdiction

The judgment and order of the Court of Appeals was entered August 3, 1973. The jurisdiction of this Court is invoked under 28 U.S.C. § 1254(1).

Questions Presented

1. Whether the decision below correctly allowed a corporation to sue in its own name and behalf for depredations committed upon it by a former majority stockholder where the recovery will benefit persons in addition to present stockholders, distinguishing a 1903 state court equity decision, *Home Fire Ins. Co.* v. *Barber,* 67 Neb. 644, 93 N.W. 1024, and like cases.

2. Whether the decision below correctly held that the contemporaneous ownership requirement for derivative actions brought by stockholders does not apply to a suit brought by a corporation in its own name and behalf.

3. Whether the decision below, which involves the scope of an equitable defense in a suit between private parties, conflict with *Sierra Club* v. *Morton,* 405 U.S. 727 (1972), which involves review of administrative action under the Administrative Procedure Act.

Statutes, Rules, and Regulations Involved

Respondents maintain that no statutes, rules, or regulations are involved in the decision below. The text of the following statutes and rules are set out in the appendixes for the convenience of the court:

1) Rule 10b-5 [17 C.F.R. § 240.10b-5], adopted by the Securities and Exchange Comission pursuant to § 10(b) of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)] Appendix A, at p. 14

2) Section 10 of the Clayton Act [15 U.S.C. § 20] Appendix B, at p. 14

3) Sections 15 and 104 of the Maine Public Utilities Act [35 M.R.S.A. §§ 15 and 104] Appendix C, at p. 15

4) Rule 23.1, F.R.Civ.P. Appendix D, at p. 17

Statement of the Case

This suit is brought by the Bangor and Aroostook Railroad Company (BAR) and its wholly owned subsidiary the Bangor Investment Company (BIC). BAR is a Maine corporation organized in 1891. It operates a railroad providing essential services for those persons and businesses located in the northern half of Maine. Its Comparative General Balance Sheet as contained in the Railroad Annual Report, Form A, for the year ending December 31, 1972, as filed with the Interstate Commerce Commission, shows assets of $67,726,890.

This suit was authorized by the BAR Board of Directors. During the summer of 1971 there had been made public a report to the Interstate Commerce Commission prepared by the Bureau of Accounts of the Commission, entitled "Review of Diversified Holding Company Relationships and Transactions of Bangor Punta Corporation." The Report stated:

> "The purpose of the review was to explore the impact of the Bangor Punta Corporation on the Bangor & Aroostook Railroad while it was owned by and under the control of this diversified holding company and to determine whether or not the intercompany relationships and resulting financial transactions were detrimental to the carrier."

The Report included a recommendation:

> "We recommend that all legal remedies be explored to require the holding company, which sold the carrier, to pay back to the carrier for assets taken with no compensation and charges made where no services were performed."

This Report was discussed at a meeting of the BAR board, attended by fifteen of the seventeen directors, held on July 29, 1971. Since some of the directors were not familiar with the Report, no formal action was taken. On August 26, 1971, copies of the Report were mailed to all the BAR directors. At a subsequent meeting held December 8, 1971, attended by ten directors, outside counsel discussed in detail a draft complaint, naming Bangor Punta Corporation (BP) and Bangor Punta Operations (BPO) as defendants, and explained the legal basis of the various claims contained therein. It was unanimously voted to authorize the BAR Chief Executive Officer to commence and conduct litigation against BP and BPO.

The original complaint was filed in the U.S. District Court for the District of Maine on December 30, 1971, and an amended complaint was filed on August 18, 1972. Both complaints contained thirteen counts asserting violations of § 10(b) of the Securities Exchange Act [15 U.S.C. § 78j(b)]

and Rule 10b-5 thereunder [17 C.F.R. § 240.10b-5], § 10 of the Clayton Act [15 U.S.C. § 20], § 104 of the Maine Public Utilities Act [35 M.R.S.A. § 104], and the Maine common law. As examples, one count under each theory will be discussed in detail.

1) *Rule 10b-5*

Count VI alleges that in September 1962, BIC owned 67,789 shares of stock in the St. Croix Paper Company, worth in excess of $2,000,000. The Bangor & Aroostook Corporation (BAC), the predecessor of BP and BPO, learned from inside sources that the Georgia Pacific Corporation was negotiating with St. Croix to make a tender offer to St. Croix stockholders. Before the information became public and without disclosing this information to either BAR or BIC, BAC caused BAR and BIC to enter into a three-way agreement whereby BAC ended up owning all the 67,789 shares of St. Croix stock. As a result BAR and BIC suffered damages of approximately $1,500,000, which is the profit that BAC made on the exchange of St. Croix stock for Georgia Pacific stock, which occurred shortly thereafter, and on the subsequent appreciation of Georgia Pacific stock.

2) *Section 10 of the Clayton Act*

Count IV alleges that in September 1962, BAR and BAC, which owned around 97% of the stock of BAR at the time, had nine overlapping directors. As part of the three-way transaction involving the St. Croix stock between BAC, BAR and BIC, described above, some $1,018,000 par value of BAC preferred stock was transferred to BAR at its par value of $100 per share. There was no bidding conducted, as required under § 10 of the Clayton Act, to determine the

most favorable bid for the BAR. The fair market value of the BAC preferred stock was substantially less than par and than the fair market value of the St. Croix stock whereby BAR suffered damages.

3) *Maine Public Utilities Laws: 35 M.R.S.A. § 104*

Count II alleges that through the years, first BAC and then its successor BPO, all the while owning in excess of 97% of BAR's voting stock, billed BAR for "corporate charges" and received payment from BAR of the following amounts:

Year	*Amount*
1962	$ 70,000
1963	96,000
1964	155,000
1965	165,000
1966	204,000
1967	120,000
	$810,000

None of these contracts, arrangements or payments was submitted to the Maine Public Utilities Commission for approval as required,* and, in fact, these arrangements were adverse to the public interest and would have been disapproved if submitted, because virtually no services were actually performed for BAR. Thus, BAR was damaged by paying out cash without receiving any consideration in return.

* Under Maine law railroads are public utilities. 35 M.R.S.A. § 15. See Appendix C. p. 16-17.

4) *Maine Common Law: Conversion*

Count I alleges that the same $810,000 in payments to BAC and to BPO, as discussed immediately above, were paid out in consideration for nothing but nominal services, and that the payments were authorized by officers and directors who were also officers and directors of BAC or BPO, and hence who had conflicting loyalties, and who placed the interests and welfare of BAC and BPO ahead of BAR's. Thus, these payments amount to conversion and misappropriation of assets of BAR.

5) *Other Counts*

The other counts in the complaint included causing BAR to pay illegal special dividends, causing BAR to excuse for no consideration interest payments on debts owed to BAR, and causing BIC to engage in illegal borrowing.

Approximately 99% of the stock of BAR is now owned by the Amoskeag Company (Amoskeag), a diversified operating company, registered under the Securities Exchange Act of 1934*, with its stock publicly held and traded. Amoskeag had purchased about 98% of the stock of BAR from BP and BPO on October 2, 1969, and acquired the other 1% in miscellaneous small transactions since that time. It is alleged that the domination and control of BAR by BP, BPO, and their predecessor, BAC, "resulted in fraudulent concealment of the systematic exploitation of BAR and, further, prevented any effective investigation being made of such exploitation and the commencement of any suit with respect thereto until after BAR was sold in 1969."

* Amoskeag formerly was an investment company, registered under § 8 of the Investment Company Act of 1940, 15 U.S.C. § 80a-8, but this registration ceased by S.E.C. order effective November 3, 1972.

Proceedings in the District Court and the Court of Appeals

On September 14, 1972, BP and BPO filed in the district court a motion for summary judgment, and on December 29, 1972, the district court entered an order granting this motion. The accompanying opinion read in part:

> "[W]hether the federal rule [Rule 23.1, F.R.Civ.P.] or Maine law is applicable, Amoskeag could not maintain a derivative action. . . . Amoskeag . . . is attempting to accomplish indirectly what it could not do directly. . . . [P]laintiffs' [BAR and BIC's] claims are typical stockholder claims . . . Equitable considerations must be applied in such actions. . . . Since Amoskeag . . . is the real beneficiary . . . , the corporate claims must fail for lack of equity on the part of those who would ultimately benefit from any corporate recovery." 353 F.Supp. at 728

BAR and BIC filed a *Notice of Appeal* on January 26, 1973.

In an opinion dated August 3, 1973, the court of appeals reversed the district court and held that BAR and BIC could proceed to assert their claims both under federal and state law.

BP and BPO filed their petition for a writ of certiorari with this Court on October 31, 1973.

Reasons for Denying the Writ

I. The decision below correctly applied traditional equitable principles to hold that a corporation can sue in its own name and behalf for depredations committed upon it by a former majority stockholder where the recovery will benefit persons in addition to present stockholders.

The district court relied upon a 1903 state court equity decision, *Home Fire Ins. Co.* v. *Barber*, 67 Neb. 644, 93 N.W. 1024, to dismiss plaintiffs' suit on the grounds that BAR's chief stockholder, Amoskeag, as the sole beneficiary, would be unjustly enriched by any recovery. The court of appeals found differently:

> "We reject the premise—critical both to the district court's holding and to the *Home Fire* rationale—that BAR's chief stockholder, Amoskeag, would be the 'sole beneficiary' of a recovery for BAR. The premise, applied to a rail carrier, seems to us an oversimplification, although, without doubt, BAR's recovery would be highly beneficial to Amoskeag, because of the nature of their services and of regulatory restrictions affecting them, and, more generally because of their legal status as 'quasi-public corporations', railroads cannot be described as mere alter egos of their chief stockholders." 482 F.2d at 868

Having found that there were interests affected by a recovery beyond that of the chief stockholder, the court of appeals concluded, on equitable principles, that the action should be allowed since to do otherwise would be to grant the alleged wrongdoers "an undeserved immunity from suit, to the disadvantage of the public, solely to avoid a windfall to Amoskeag which, whatever its own lack of equity, is neither a wrongdoer nor a participant in any wrong." 482 F.2d at 870-1

The above, we submit, is all that is involved in the court of appeals decision. It is merely an application of traditional equitable principles to avoid letting wrongdoers escape liability for their wrongful actions.

The decision does not enlarge the scope of any federal or state cause of action. It does not deal with the questions of whether plaintiffs have indeed stated causes of action under the Clayton and Securities Exchange Acts, and it specifically reserves the question of whether there are private causes of action under the Maine Public Utilities Act. 482 F. 2d at 867 and 871-2. It does not raise any issues so as to create a conflict with any decision of any federal or state court.

In *Janigan* v. *Taylor*, 344 F.2d 781, 786 (CA1 1965) certiorari denied 382 U.S. 879, cited with approval in *Affiliated Ute Citizens* v. *U.S.*, 406 U.S. 128, 155 (1972), the Court of Appeals for the First Circuit stated that "it is more appropriate to give the defrauded party the benefit even of windfalls than to let a fraudulent party keep them." This case applies that earlier language to the facts of this case.

Since the court of appeals has done nothing more than determine that equitable principles allow maintenance of the action, there is, we respectfully submit, no need for further review by this court.

II. The decision below does not conflict with the contemporaneous ownership requirement of Rule 23.1, F.R.Civ.P., because this suit is brought by the corporation itself and not derivatively by a stockholder.

Rule 23.1, F.R.Civ.P., requiring contemporaneous ownership, applies only to actions brought by a *stockholder* in behalf of a corporation that has "failed to enforce a right which may properly be asserted by it." Rule 23.1, F.R.Civ.P. In this case, the *corporation*, BAR, has acted to enforce its rights; Rule 23.1 does not apply. *Central Ry. Signal Co.* v.

Longden, 194 F.2d 310, 321 (CA7 1952) (alternate holding). The court of appeals in its opinion did not treat Rule 23.1 as applying to this case. 482 F.2d at 868, n.2. The contemporaneous ownership rule determines the standing of a stockholder to assert a claim of his corporation in behalf of the corporation. See *Ross* v. *Bernhard*, 396 U.S. 531, 538 (1970). If the stockholder lacks standing, the court will "abate the action without respect to the merits" so that another stockholder may pick up the suit. *Liken* v. *Shaffer*, 64 F.Supp. 432, 442 (ND Iowa 1946). But here the BAR board of directors authorized the suit to be brought by BAR itself. Clearly, Rule 23.1 is not applicable.

Nor are the purposes of Rule 23.1 served by applying it in this case. As the court of appeals decision observes: "The underlying policies for the adoption of the Rule—preventing transfer of a few shares to a non-resident to acquire diversity jurisdiction and to discourage strike suits—relate to abuses associated with minority stockholder proceedings." 482 F.2d at 868, n.2. This is neither a strike-suit nor a suit where jurisdiction has been collusively created. There is no basis for the assertion in BP-BPO's petition, p. 11, that the purpose of Rule 23.1 is to prevent uninjured stockholders from benefiting from a corporate recovery. The cases hold that, when a corporation wins a lawsuit, it recovers its full damages, and the damages are not reduced by the percentage of stockholders who acquired their stock after the wrongs for which the corporation was suing. *Norte & Company* v. *Huffins*, 416 F.2d 1189, 1190-1, (CA2 1969), *Central Ry. Signal Co.* v. *Longden*, 194 F.2d 310, 322 CA7 1952), *Overfield* v. *Pennroad Corp.*, 48 F.Supp .1008, 1018 (ED Pa 1943).

Since the decision below does not conflict with either the

contemporaneous ownership requirement of Rule 23.1 or the purposes behind the requirement, certiorari should not be granted on this ground.

III. The decision below does not conflict with *Sierra Club* v. *Morton*, 405 U.S. 727 (1972), because this case involves claims between private parties and not review of administrative action under the Administrative Procedure Act.

In this case two private parties, BAR and BIC, are seeking to recover from two other private parties funds that were wrongfully taken from BAR and BIC. This is not a case involving review of administrative action taken under the Administrative Procedure Act as is *Sierra Club* v. *Morton*, 405 U.S. 727 (1972), where the court viewed its task as the interpretation of § 10 of the Administrative Procedure Act, 5 U.S.C. § 702. The case of *Data Processing Service* v. *Camp*, 397 U.S. 150 (1970), also involved review of administrative action under the Administrative Procedure Act and under the federal banking laws.

The absence of conflict with *Sierra Club* and *Data Processing* is highlighted by the failure of BP and BPO even to mention them, either in brief or in oral argument, before either the district court or the court of appeals. Further neither of the courts below discussed or even cited in their opinions *Sierra Club* or *Data Processing*.

Thus, the decision below does not conflict with *Sierra Club* or with *Data Processing*.

Conclusion

Since the decision below correctly applies traditional equitable principles and does not conflict with existing law, the petition for a writ of certiorari should be denied.

EDWARD O. PROCTOR
ALAN L. LEFKOWITZ
EDWARD T. ROBINSON
Attorneys for Respondents

Of Counsel:
VERRILL, DANA, PHILBRICK,
PUTNAM & WILLIAMSON

Appendix A

Rule 10b-5 (17 C.F.R. § 240.10b-5), adopted by the Securities and Exchange Commission pursuant to § 10b of the Securities Exchange Act of 1934 [15 U.S.C. § 78j(b)], reads as follows:

> It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,
>
> (a) To employ any device, scheme, or artifice to defraud,
>
> (b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or
>
> (c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person

in connection with the purchase or sale of any security.

Appendix B

Section 10 of the Clayton Act [15 U.S.C. § 20] reads in pertinent part as follows:

> No common carrier engaged in commerce shall have any dealings in securities, supplies, or other articles of commerce, or shall make or have any contracts for con-

struction or maintenance of any kind, to the amount of more than $50,000, in the aggregate, in any one year, with another corporation, firm, partnership, or association when the said common carrier shall have upon its board of directors or as its president, manager, or as its purchasing or selling officer, or agent in the particular transaction, any person who is at the same time a director, manager, or purchasing or selling officer of, or who has any substantial interest in, such other corporation, firm, partnership, or association, unless and except such purchases shall be made from, or such dealings shall be with, the bidder whose bid is the most favorable to such common carrier, to be ascertained by competitive bidding under regulations to be prescribed by rule or otherwise by the Interstate Commerce Commission. No bid shall be received unless the name and address of the bidder or the names and addresses of the officers, directors, and general managers thereof, if the bidder be a corporation, or of the members, if it be a partnership or firm, be given with the bid.

Appendix C

Section 104 of the Maine Public Utilities Act [35 M.R.S.A. § 104] reads as follows:

No public utility doing business in this State shall extend credit or make loans to or make any contract or arrangement, providing for the furnishing of management, supervision of construction, engineering, accounting, legal, financial or similar services, or for the furnishing of any service other than those enumerated, with any corporation, person, partnership or trust, holding, controlling or owning in excess of 25% of the

voting capital stock of such public utility, or with any other corporation which is itself owned or controlled by or affiliated with any corporation, person, partnership or trust, holding, controlling or owning a majority of the voting capital stock of such public utility, unless and until such contract or arrangement shall have been found by the commission not to be adverse to the public interest and shall have received their written approval. The commission shall in the case of any utility have the power to exempt herefrom, from time to time, such classes of transactions as it may specify in writing in advance and which in its judgment will not affect the public interest.

Section 15 of the Maine Public Utilities Act [35 M.R.S.A. § 15] reads as follows:

Wherever used or referred to in chapters 1 to 17, unless a different meaning clearly appears from the context:

...

3. *Common carrier.* "Common carrier" includes every railroad company, express company, dispatch, sleeping car, dining car, drawing-room car, freight line, refrigerator, oil, stock, fruit, car loaning, car renting, car loading and every other car corporation or person, their lessees, trustees, receivers, or trustees appointed by any court whatsoever, operating for compensation within this State; and every corporation or person, their lessees, trustees, receivers or trustees appointed by any court whatsoever, owning, controlling, operating or managing any vessel regularly engaged in the trans-

portation of persons or property for compensation upon the waters of this State or upon the high seas, over regular routes between points within this State. 1961, c. 395, § 23.

...

13. *Public utility.* "Public utility" includes every common carrier, gas company, natural gas pipeline company, electrical company, telephone company, telegraph company, water company, public heating company, wharfinger and warehouseman, as those terms are defined in this section, and each thereof is declared to be a public utility and to be subject to the jurisdiction, control and regulation of the commission, and to chapters 1 to 17. 1955, c. 127, § 1.

Appendix D

Rule 23.1, F.R.Civ.P., reads as follows:

In a derivative action brought by one or more shareholders or members to enforce a right of a corporation or of an unincorporated association, the corporation or association having failed to enforce a right which may properly be asserted by it, the complaint shall be verified and shall allege (1) that the plaintiff was a shareholder or member at the time of the transaction of which he complains or that his share or membership thereafter devolved on him by operation of law, and (2) that the action is not a collusive one to confer jurisdiction on a court of the United States which it would not otherwise have. The complaint shall also allege with particularity the efforts, if any, made by the plaintiff to

obtain the action he desires from the directors or comparable authority and, if necessary, from the shareholders or members, and the reasons for his failure to obtain the action or for not making the effort. The derivative action may not be maintained if it appears that the plaintiff does not fairly and adequately represent the interests of the shareholders or members similarly situated in enforcing the right of the corporation or association. The action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to shareholders or members in such manner as the court directs.

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JAMES V. RYAN
ROGER L. WALDMAN
ALLAN J. GRAF
One Rockefeller Plaza
New York, New York 10020.
Counsel for Petitioners

WEBSTER SHEFFIELD FLEISCHMANN
HITCHCOCK & BROOKFIELD
BERNSTEIN SHUR SAWYER & NELSON,
Of Counsel.

February 21, 1974.

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Opinions Below

The opinion of the District Court is reported at 353 F. Supp. 724 (D. Me. 1972) and is reproduced at pp. 30-41 of the Appendix (App.). The opinion of the Court of Appeals for the First Circuit (App. 54-67) is reported at 482 F. 2d 865.

Jurisdiction

The Judgment of the First Circuit, reversing the decision of the District Court, was entered on August 3, 1973. The Petition for a Writ of Certiorari was filed October 31, 1973, and was granted January 7, 1974. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. § 1254(1).

Questions Presented

(1) Whether a litigant who has himself suffered no injury can bring suit in a federal court to vindicate the rights of the general public.

(2) Whether the fact that a corporation is a railroad or other "public" or "quasi-public" corporation changes the applicable rules with respect to standing so as to permit actions by the general public for alleged violations of the federal securities and anti-trust laws and for common law corporate waste and mismanagement.

(3) Whether the requirement of contemporaneous share ownership embodied in Rule 23.1 of the Federal Rules of Civil Procedure may be evaded in actions involving corporations whose business affects the public welfare.

Statutes and Regulations Involved

The following statutes and regulations are involved: U.S. Const. art. III, § 2; U.S. Const. amend. XI; Clayton Act § 10, 15 U.S.C. § 20; Securities Exchange Act of 1934, § 10(b), 15 U.S.C. § 78j(b); SEC Rule 10b-5, 17 C.F.R. § 240.10b-5; Interstate Commerce Act, Part I, §§ 1(14), 1(18), 1(21), 5(2)(a), 8, 15(1), 20a(2), 49 U.S.C. §§ 1(14), 1(18), 1(21), 5(2)(a), 8, 15(1), 20a(2); Maine Public Utilities Act § 104, 35 M.R.S.A. § 104; and Rule 23.1 of the Federal Rules of Civil Procedure. The text of pertinent parts of the statutes and regulations are set forth in an appendix to this brief.

Statement of the Case

Plaintiff-respondent Bangor and Aroostook Railroad ("BAR") is a Maine corporation which operates a railroad within the State of Maine. Plaintiff-respondent Bangor Investment Company ("BIC") is its wholly owned subsidiary. Both companies are controlled by Amoskeag Company, ("Amoskeag"), a Delaware corporation which owns 99.3% of the outstanding capital stock of BAR.

Defendant-petitioners Bangor Punta Corporation ("Bangor Punta"), a publicly held Delaware corporation, and Bangor Punta Operations ("BPO"), its wholly owned subsidiary, are former owners of a controlling interest in BAR. BPO owned 98.3% of the capital stock of BAR prior to October 2, 1969, on which date it sold its holdings of BAR stock to Amoskeag for approximately $5,000,000.

The instant action, brought nominally by BAR and BIC, was commenced on December 30, 1971 and seeks damages of $7,000,000. Although the complaint frames various causes of action under the common law of Maine; Section 10(b) of the Securities and Exchange Act of 1934, 15 U.S.C. § 78j(b) and SEC Rule 10b-5 (17 C.F.R. § 240.10b-5) thereunder; Section 10 of the Clayton Act, 15 U.S.C. § 20; and Sections 104 and 15 of the Maine Public Utilities Act (35 M.R.S.A. §§ 104 and 15), all the counts essentially allege mismanagement and waste of BAR's corporate assets during the time Defendant-petitioners controlled BAR, claims customarily found in the usual shareholders derivative action. The complaint makes no allegation of injury to the public, nor does it allege the suit is brought on the public's behalf.

On September 14, 1972, Defendant-petitioners moved for summary judgment pursuant to Rule 56 of the Federal Rules of Civil Procedure. By order dated December 29, 1972, the United States District Court for the District of Maine (Edward T. Gignoux, D.J.) granted Defendant-petitioners summary judgment and dismissed the action on the ground that, from the undisputed facts of the case, Plaintiff-respondents were precluded by well established equitable principles from maintaining the action.

The District Court's opinion emphasized three crucial and uncontested facts (App. 32-33):

> (1) the real plaintiff and party in interest, and the beneficiary of any recovery, was Amoskeag, the more than 99% owner of the corporate plaintiffs;
>
> (2) Amoskeag has made no claim that it was defrauded or received less than full value for its